

## FELLOW NOTES

# CPI, GDP, AND CORE INSTITUTIONS

*“Corruption in any form – dispersed or concentrated – is destructive to the core institutions of society”*

Ronald K. Mitchell | May 13, 2016 |      



Recently I was talking with a colleague from a country that in 2015 ranked 130<sup>th</sup> out of 167 countries on Transparency International’s *Corruption Perceptions Index* (CPI). For those who may be unfamiliar with the *Corruption Perceptions Index*, it is a means whereby each country in the world is rated by at least three reputable entities that give the country a score on the extent to which public officials in that country use public office for private gain. Countries are then ranked based upon this score. By way of comparison, the USA ranked 16<sup>th</sup>, behind Canada (9<sup>th</sup>) New Zealand (4<sup>th</sup>) and Denmark, Finland and Sweden (1<sup>st</sup>, 2<sup>nd</sup>, and 3<sup>rd</sup> – least corrupt/ most transparent). This colleague expressed a view regarding the *Corruption Perceptions Index* that I had never before considered; and as a person who has taught courses that deal with ethics in both the business and society context, I thought his ideas were worthy of discussion. Here is a broad paraphrase of the view

### ABOUT RONALD K. MITCHELL



Ronald K. Mitchell is a Fellow at the Wheatley Institution, and currently holds the Jean Austin Bagley Regents Chair in Management in the Jerry S. Rawls School of Business at Texas Tech University.

MORE FROM  
RONALD K. MITCHELL

stated by my colleague:

This colleague expressed a view regarding corruption that I had never before considered...

*The CPI (Corruption Perceptions Index) is accurate only to a point because it **does not** capture concentration of corruption. It **does**, however, capture its dispersion. In my country “so-called corruption” is **dispersed**: every little interaction with an official in government or in education, for example, requires some kind of payment that we think of as a “motivation” fee for that service.*

*In the USA, however, corruption is **concentrated at the top**; therefore, the population is not antagonized with the small/dispersed corruption that the CPI measures. Instead, in the USA, the whole country pays for robber barons at the top who have privileged access to government through campaign donations, PACs, and lobbying money. The result is a greater diversion to private ends through concentrated corruption (of the public purse and of the returns from regulated commerce), than there is in my country through corruption’s wide dispersion. It may well be that in absolute magnitude, the USA is more corrupt than my country.*

As I’ve thought about my colleague’s view, I couldn’t help but think of Harvard historian Niall Ferguson’s 2012 book, *The Great Degeneration*, because in this book Ferguson provides a working context within which to consider the dispersion vs. concentration of corruption problem. In this book he addresses “the great degeneration of our laws and institutions.” And given our Wheatley Institution mission to “... lift society by preserving and strengthening its core institutions,” it seems to me to be appropriate to examine more closely, in the *Wheatley Notes* forum, the relationship between the concentration and dispersion of corruption and the degeneration of our institutions. Ferguson argues persuasively that, from a historical perspective, four core institutions presently are degenerating: democracy, capitalism, the rule of law, and a civil society. He argues that “... where bad institutions pertain, people

Positive Networks  
and Public Goods

MORE FROM  
BUSINESS ETHICS

Managing  
Through Layoffs:  
Lessons from  
Research  
Kim S. Cameron

The First Step is to  
Recognize When  
an Issue is an  
Ethical One  
Bill O'Rourke

The Power of  
Ethical Examples  
W. Steve Albrecht

get stuck in vicious circles of ignorance, ill health, poverty, and, often, violence.”

A few years ago some PhD students and I became curious about the connection between corruption and poverty. So we ran a simple correlation analysis that compared the score of each country listed in the *Corruption Perceptions Index* (CPI) to its per capita *Gross Domestic Product* (GDP). The correlation exceeded 70% – as CPI score went down, so did GDP per capita. While recognizing that correlation does not imply causation, it nevertheless is interesting to note that economic productivity is positively correlated with the absence of CPI-measured corruption. So what of the issue of corruption’s relative dispersion within a country or society – and especially the question of its concentration at the top of the ostensibly less corrupt societies?

**Economic productivity is positively correlated with the absence of CPI-measured corruption.**

In an article that appeared online last month<sup>[1]</sup>, two colleagues from Yale University speak to this question. The article concerns the approval sought from the Securities and Exchange Commission (SEC) for a stock exchange that levels the “nearly-instant arbitrage” playing field. Colleagues Macy and Swensen<sup>[2]</sup> have written:

“Right now there’s a battle over upstart trading platform IEX’s application for exchange status.

And it’s become an existential test of the SEC’s role in the capital markets.

On one side, IEX is trying to make markets fairer for long-term investors by mitigating the market manipulation and other shenanigans identified by Michael Lewis in his 2014 book “Flash Boys: A Wall Street Revolt.”

On the other side, exchanges – like BATS Global Markets (BATS),

Nasdaq and the New York Stock Exchange (NYSE) – and high frequency trading firms (HFTs) seek to protect the ill-gotten privileges that facilitate their riskless parasitic profit taking.

Whether the SEC approves or denies IEX's application will indicate whether the SEC is an administrative agency that works to protect investors and markets, or whether it is the sort of inside-the-beltway bureaucracy captured by special interest groups and self-interested bureaucrats.

Of the 443 comment letters that the SEC has received on IEX's exchange application, 92% of those expressing a position support IEX's application. Only 8% oppose.

But, the SEC is not a democracy.

Winners in battles like this are, almost inevitably, small, well-organized, highly concentrated interest groups that stand to benefit from the regulation. The losers in the SEC administrative process tend to be large, diffuse groups like investors.

Special interest groups can deploy their ill-gotten gains to provide jobs to former SEC commissioners and staffers, purchase political support from members of Congress and orchestrate expert testimony for SEC hearings.

Widely disbursed interest groups cannot answer in kind, because the burdens of the regulations, while high, are spread among the members of the investing public."

So when Ferguson, echoing Adam Smith, argues that "... both stagnation and growth are in large measure the results of laws and institutions"; and when he states further: (1) that "... not all sets of institutions are equal," (2) that "... history suggests that there are more suboptimal [sets] than there are optimal [ones]," and therefore (3) that "...this is why most countries have been poor for most of history, as well as illiterate, unhealthy and bloody," he is arguing

for the Wheatley Institution Mission. It seems clear to me that we as human beings can be placed at risk both by the dispersion of corruption, *and* by its concentration. We need to redouble our efforts to reduce both types. But what can be done?

**We need to redouble our efforts to reduce both types. But what can be done?**

Helpfully, the 1995 founder of the Corruption Perceptions Index, Johann Graf Lambsdorff has a suggestion. In his 2007 book *The Institutional Economics of Corruption and Reform*, he argues that as a society we are going about the drafting and enforcement of anti-corruption laws all wrong. Remembering that the working definition of corruption is “the use of public office for private gain,” and recognizing that

corruption takes two to engage in a corrupt transaction (e.g., a bribe giver, and a bribe taker), Lambsdorff argues that equal punishment of both parties actually supports and preserves these corrupt bargains, because there is incentive for secrecy for both parties. He suggests (in a footnote, along with co-author Mathias Nell), instead of equal punishments for the violation of anticorruption laws, that “... an asymmetric design of sanctions might unleash higher deterrent effects of anticorruption laws.” In short, if bribe givers (whose intent is to corrupt some public official) are punished severely, while bribe takers (who are corrupted through the bribe) are not punished, or lightly so; then there is incentive for one party to inform on the other, and thereby (through the possibility for extortion) to insert instability into the corrupt bargain. Or, in the terminology of Lambsdorff and Nell: an uneven (asymmetric) punishment design will “... shatter some of the confidence that corrupt favors will be reciprocated, and foster whistle blowing.”

So, what of the relationship between the concentration and dispersion of corruption and the degeneration of our institutions? In this Note I have advanced three ideas in response to this question:

1. That corruption in any form – dispersed or concentrated – is destructive to the core institutions of society
2. That in the USA, we presently are lower in dispersed corruption than are most countries; but may be more at risk of more concentrated corruption than the *Corruption Perceptions Index* might indicate; and therefore we may be more at risk of the degeneration of key institutions of democracy, capitalism, rule of law, and civility; and
3. That efforts to lower the degenerating effects of corruption should be redoubled; and in particular that our anti-corruption legal framework should carefully be examined to ensure that the incentives therein work toward deterrence of both dispersed and concentrated corruption.

## Our core institutions depend upon honesty

I conclude this Note with the sentence that begins Lambsdorff's book: "*Those who are willing to carry out corrupt acts lose the capacity to commit to honesty.*" Our core institutions depend upon honesty. As a member of the Wheatley Institution Ethics Initiative, I see a strong connection among low corruption (dispersed or concentrated), GDP, and strong core institutions in society.

---

[1] Jonathan Macey and David Swensen, <http://www.businessinsider.com/iex-battle-with-market-establishment-2016-4>

[2] Jonathan Macey is a professor in the Yale Law School and David Swensen is Chief Investment Officer of Yale. Yale has an indirect investment in IEX, which is valued at \$600,000 or approximately 0.002% of the University's \$25.6 billion endowment.